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How far can this go?

- **Confidence indices for the manufacturing sector continue to rise**
- **This is corroborated by trade data in Asia**
- **Fed sticking to its guns, but the inflation conundrum remains**

An optimist like me is always looking for positive economic signals that confirm an optimistic view, in this case on the short-term outlook for the global economy. This year has been good to me. The synchronised global recovery has gained strength and forecasts for economic growth have been raised in the course of the year. All of this was signalled by the stellar rise in business confidence indices that started around the middle of last year. As these indices moved higher and higher, even an optimist like me started to wonder about when they would turn and how fast they might fall. And, truth be told, some of these indices have reached highs in past months that are not often exceeded. Therefore, I thought they might turn and move lower, though not very fast.

The amazing PMIs

Looking at recent data, it looks to me as though that isn't happening. For what it is worth, the preliminary Markit PMI data for the eurozone and for a few individual key eurozone economies suggest that growth momentum in the manufacturing sector of the economy isn't easing at all, quite the opposite. Of course, we can have a debate about a gap between confidence indices and the so called hard data such as industrial output and GDP. Many economists think that the hard data is more relevant. I am not so sure, in fact, I disagree. The confidence indices started to improve around the middle of last year in many countries. The hard data was slow to follow, but that eventually happened. I think the message is that the soft data can signal what is likely to happen next, particularly if these confidence indices are so consistent in many countries.

The Markit PMI for the manufacturing sector in Germany was reported on a preliminary basis as 60.6 in September, up from 59.3. The last time this index reached such a level was in 2011, just before the euro crisis pushed the eurozone economy in recession. The growth rate of the German economy was then over 3%! I am not saying that is where we are heading, but it is at least remarkable. The same gauge for France also rose in September, though not as much as in Germany.

The US Markit PMI-manufacturing for September was also a touch higher than in August, 53.0 versus 52.8, but the rise here is less compelling. Nevertheless, even the US data contributes to the view that momentum is not weakening but strengthening.

Germany Markit PMI manufacturing

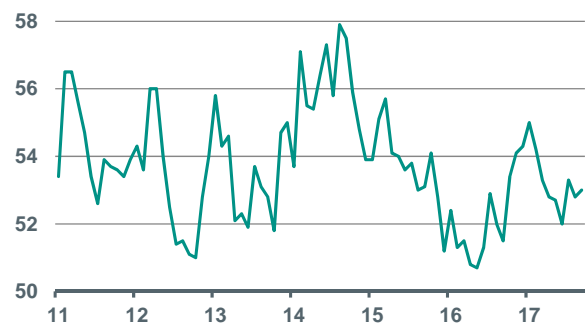
Index, 50 is neutral



Source: Thomson Reuters Datastream

US Markit PMI manufacturing

Index, 50 is neutral



Source: Thomson Reuters Datastream

Supportive trade data in Asia

The question then is whether this is just a fluke, soon to be reversed or if evidence can be found elsewhere supporting the message from these indices that momentum in the manufacturing sector is still gaining strength. Taiwan, a good gauge for the health of global trade, released data on export orders for August recently. They were up 7.5% yoy. That was down from 10.5% in July and 13.0% in June. Nevertheless, Taiwanese export growth numbers have benefitted in the first half of the year from a base effect. As export orders were very weak in the first half of 2016, the yoy-comparison was made easy. The first time export orders were up yoy in 2016 was in August. So the friendly base effect is now over. Taking that into account, I think the August 2017 data is not bad at all.

Taiwan: Export orders

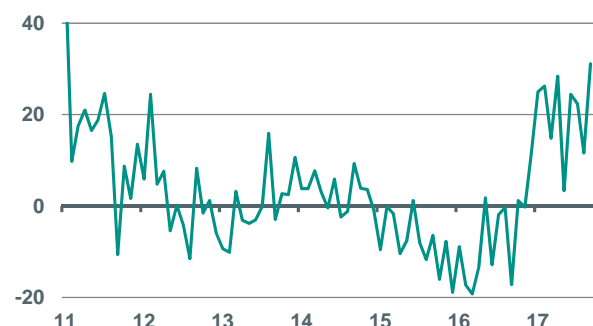
% yoy



Source: Bloomberg

Korea: Exports

First 20 days, % yoy



Source: Bloomberg

South Korea is another economy heavily dependent on the international trade cycle, which is obviously strongly related to the manufacturing sector. It published export and import data for the first 20 days of September recently. They were unambiguously strong. Exports were up 31.1% yoy, after 11.6% in August, while imports grew by 23.9% against 11.2% in August. These numbers were flattered by the number of trading days, but even adjusting for that factor, one cannot escape the conclusion that this data is strong.

Japan's trade data for August is also showing strength. Japanese exports were up 18.1% yoy (up from 13.4% and the highest growth rate since 2013), while imports gained 15.2%, slightly lower than July's 17.3%.

It isn't exactly scientific evidence, but the combination of the PMIs, and the trade data in some Asian countries suggests that global momentum in manufacturing is at least being maintained. That is a big positive for the global economy.

Fed sticking to their guns

My colleague Nick Kounis commented on the US Fed's decisions and communications following their most recent policy meeting. The FOMC did not change the 'dot plot', meaning that the median of their projections is still suggesting one more hike this year and three next year. We changed our view recently and now believe that there will not be a rate hike before Christmas and only two next year. Nick highlighted that the 'dot plot' does not distinguish between voting and non-voting members and that the voting members may be a little more dovish than the total. Nevertheless, it is fair to say that the chance that the Fed will hike once more before the end of the year is significant.

The key uncertainty in this equation is what will happen to inflation and, even more important, how the Fed will weigh that. I have long had the belief that the US economy is characterised by strong disinflationary forces. That is not to say that, in my view, inflation will certainly ease further in the months ahead. Higher oil prices, the lower dollar and the tight labour market may push inflation up in the months ahead. But longer term, I think the Fed will find it difficult to achieve its inflation target. And there is at least a possibility that the data of the months ahead will bear that out already. The question is how the Fed should weigh that. In my opinion, the Fed should not desperately stick to its inflation target. If they do that, they are likely to keep monetary policy too easy. But the Fed should take the longer-term outlook for low inflation into account and realise that in such an environment interest rates need not to rise as much as in a situation in which inflation returns to historically more normal levels.

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Main economic/financial forecasts											
GDP growth (%)	2015	2016e	2017e	2018e	3M interbank rate	14/09/2017	21/09/2017	+3M	2017e	+12M	2018e
United States	2.9	1.5	2.3	2.5	United States	1.32	1.33	1.30	1.30	1.80	1.80
Eurozone	1.9	1.8	2.3	2.2	Eurozone	-0.33	-0.33	-0.33	-0.33	-0.33	-0.33
Japan	1.1	1.0	1.5	1.3	Japan	0.06	0.06	-0.10	-0.10	-0.10	-0.10
United Kingdom	2.2	1.8	1.6	1.4	United Kingdom	0.30	0.33	0.40	0.40	0.40	0.40
China	6.9	6.7	6.8	6.5							
World	3.5	3.3	3.6	3.7							
Inflation (%)	2015	2016e	2017e	2018e	10Y interest rate	14/09/2017	21/09/2017	+3M	2017e	+12M	2018e
United States	0.1	1.3	1.9	1.7	US Treasury	2.20	2.28	2.2	2.20	2.40	2.50
Eurozone	0.0	0.2	1.5	1.3	German Bund	0.41	0.45	0.6	0.60	0.70	0.80
Japan	0.8	-0.1	0.7	1.0	Euro sw ap rate	0.87	0.89	1.0	1.00	1.05	1.15
United Kingdom	0.0	0.7	2.7	2.3	Japanese gov. bonds	0.03	0.03	0.0	0.00	0.00	0.00
China	1.4	2.0	1.5	2.0	UK gilts	1.23	1.37	1.4	1.50	1.10	1.80
World	2.9	2.9	3.0	3.0							
Key policy rate	21/09/2017	+3M	2017e	2018e	Currencies	14/09/2017	21/09/2017	+3M	2017e	+12M	2018e
Federal Reserve	1.25	1.25	1.25	1.75	EUR/USD	1.19	1.19	1.20	1.20	1.27	1.30
European Central Bank	-0.40	-0.40	-0.40	-0.40	USD/JPY	110.2	112.5	110	110	106	105
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.34	1.35	1.34	1.34	1.40	1.42
Bank of England	0.25	0.25	0.25	0.25	EUR/GBP	0.89	0.88	0.90	0.90	0.91	0.92
People's Bank of China	4.35	4.35	4.35	4.35	USD/CNY	6.56	6.59	6.60	6.60	6.70	6.75

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.

Key macro events 25 – 29 September 2017

Day	Date	Time	Country	Market indicator	Period	Latest outcome	Expectation consensus	ABN AMRO
Monday	25/09/2017	10:00:00	DE	Ifo - business climate - index	Sep	115.9	116.0	116.1
Monday	25/09/2017	14:30:00	US	Fed's Dudley speaks on workforce development				
Monday	25/09/2017	15:00:00	EC	ECB president Draghi speaks in Brussels				
Tuesday	26/09/2017	15:00:00	US	S&P/Case Shiller house price index	Jul	0.11	1.57	
Tuesday	26/09/2017	16:00:00	US	Conference Board cons. confidence - index	Sep	122.9	119	
Tuesday	26/09/2017	16:00:00	US	New homes sold - % mom	Aug	-9.4	3.3	
Tuesday	26/09/2017	18:45:00	US	Fed's Yellen speaks on inflation, uncertainty and monetary policy				
Wednesday	27/09/2017	10:00:00	EC	M3 growth - % yoy	Aug	4.5	4.7	
Wednesday	27/09/2017	13:00:00	CZ	Repo rate - %	Sep 27	0.25	0.27	
Wednesday	27/09/2017	14:30:00	US	New durable goods orders - % mom	Aug P	-6.8	0.9	2.5
Wednesday	27/09/2017	16:00:00	US	Pending home sales - % mom	Aug	-0.8	-0.1	
Wednesday	27/09/2017	22:00:00	NZ	Policy rate - %	Sep 28	1.75	1.75	1.75
Thursday	28/09/2017	06:30:00	NL	Producer confidence manufacturing - index	Sep	5.4		5.7
Thursday	28/09/2017	10:00:00	EC	ECB's Praet speaks in Berlin				
Thursday	28/09/2017	11:00:00	EC	Economic sentiment monitor - index	Sep	111.9	112.0	112.4
Thursday	28/09/2017	14:00:00	DE	CPI - % yoy	Sep P	1.8	1.8	1.8
Thursday	28/09/2017	14:30:00	US	Initial jobless claims - thousands	Sep 23	259	268	
Thursday	28/09/2017	14:30:00	US	GDP - % qoq annualised	2Q T	3.0	3.1	3.0
Thursday	28/09/2017	16:00:00	US	Fed's Fischer speaks at BoE Independence conference, London				
Thursday	28/09/2017	20:00:00	MX	Policy rate - %	Sep 28	7.0	7.0	
Friday	29/09/2017	01:30:00	JP	CPI - % yoy	Aug	0.4	0.6	
Friday	29/09/2017	01:30:00	JP	Unemployment - %	Aug	2.8	2.8	
Friday	29/09/2017	01:50:00	JP	Industrial production - % mom	Aug P	-0.8	1.9	
Friday	29/09/2017	03:45:00	CN	PMI manufacturing - index (Caixin)	Sep	51.6	51.5	
Friday	29/09/2017	09:55:00	DE	Unemployment - %	Sep	5.7	5.7	
Friday	29/09/2017	10:30:00	GB	GDP - % qoq	2Q F	0.3	0.3	
Friday	29/09/2017	11:00:00	EC	Core inflation - % yoy	Sep A	1.2	1.2	1.1
Friday	29/09/2017	11:00:00	EC	CPI - % yoy	Sep	1.5	1.6	1.5
Friday	29/09/2017	14:30:00	US	PCE deflator core - % mom	Aug	0.1	0.2	0.1
Friday	29/09/2017	14:30:00	US	PCE deflator core - % yoy	Aug	1.4	1.4	1.3
Friday	29/09/2017	15:45:00	US	Chicago Fed - business confidence - index	Sep	58.9	57.5	
Friday	29/09/2017	16:00:00	US	Univ. of Michigan cons. confidence - index	Sep F	95.3	95.1	
Friday	29/09/2017	16:15:00	EC	ECB's Draghi, BoE's Carney in dialog in London				

Source: Bloomberg, Reuters, ABN AMRO Group Economics (we provide own forecasts only for selected key variables and events)